Bond Case Briefs

Municipal Finance Law Since 1971

Easy Muni Money Vanishes and Issuers Are Paying Up.

- **Several muni-bond sales on pause as yields surge ever higher**
- **Era of easy money for cities is ending as the Fed hikes near**

U.S. cities and states are paying up to get muni deals off the ground as buyers gain more bargaining power — a marked departure from the anything-goes market for sellers in the easy-money era.

Issuers including Denver and New Hampshire are finding buyers now have the upper hand as the Federal Reserve's push to tighten monetary policy raises refinancing costs. A $246 million portion of a bond sale from the city of Denver had a total interest cost of 3.21% versus around 1.75% for a similar offering two years ago.

At the same time, Mississippi State University is pausing plans for a debt refinancing because yields have jumped so much that the transaction doesn't make financial sense anymore. Meanwhile Texas sold AAA rated bonds for its water loan program last week, offering a whopping 233 basis points versus just 11 basis points for its similar two-year bonds launched back in September 2021.

Another way of thinking about it: The great muni selloff is offering investors saddled with historic losses this year one small win in the form of bargain prices on new deals.

"We've seen the pricing power shift from the issuers, who were seeing that excess demand and heavy subscriptions in 2021 — we're now seeing that power shift to investors," said Christopher Lee, head of municipal-bond sales for Wells Fargo's Corporate & Investment Bank & Co. "They're being much more disciplined and selective due to having lower cash positions, rising rates and volatility as a whole."

Yields on 30-year AAA munis have jumped about 150 basis points in 2022

Tougher Market

Investors say current conditions bear soft echoes to the 2020 rout, when borrowers were forced to offer elevated payouts because of ultimately unfounded concerns that municipalities would see their finances deteriorate drastically from the pandemic.

Now money managers have sway over how issues are priced and structured, and are more comfortable turning down transactions than they were last year.

When Denver, Colorado, sold bonds last week, for example there were fewer bidders than usual on the sale, though it still amounted to a little less than a dozen bidders, according to Guadalupe Gutierrez-Vasquez, Denver's cash and capital funding director for the finance department. "We didn't see nearly as much participation," she said.

The city found that there was more interest in a taxable transaction that featured shorter-dated maturities. "Investors are definitely reluctant to go longer out on the yield curve," she said.

Still, she said that the borrowing costs in the muni market remain historically low. The yield on the Bond Buyer's 20-year index stands at about 3.2%, while it's averaged 5.5% since the 1960s, the data show.

While the primary market remains open, long-term municipal debt sales are down 11%, according to data compiled by Bloomberg. Several debt refinancings have been paused due to the market volatility. An Arizona agency delayed the sale of $146 million of bonds to refinance securities sold for the stadium home to the National Football League's Arizona Cardinals, according to Teddy Eynon, the chair of the agency's board. The agency expects to move forward with the sale over the next 30 days, he said in an emailed statement.

When it made issuance plans, New Hampshire's Department of Transportation was expecting it would generate savings of around $17 million based on yields as of early January, said Marie Mullen, director of the department's division of finance. Now thanks to the spike in interest rates, its April bond sale — which hasn't closed yet — is estimated to generate less savings than that, around $6 million, Mullen said. All the same, it still meets the savings threshold that the state looks for to conduct such refinancings.

Yield Is Back

As new deals are priced, investors are also facing elevated levels of bonds up for sale in the secondary market. The amount of bonds out for the bid on Bloomberg's platform has stayed high, averaging about $1.1 billion in 2022, about twice the level seen in 2021.

The elevated bid lists are akin to "shadow supply" each week, Lee said. "That's another form of supply the market has had to digest," he said.

Wesly Pate, a portfolio manager at Income Research & Management, said the market is behaving in a way that's "healthy."

Deals that are struggling are typically not offering enough in yield to compensate for the risks, he said. Those transactions may need the bank underwriting the debt to step in and hold some of the securities as a result.

Borrowers with lower credit ratings are having to pay higher yield penalties, known as credit spreads, to compensate investors for the risks. Revenue bonds rated A are offering over 0.6 percentage points of additional yield compared to AAA rated debt for the highest since late 2020, according to Bloomberg BVAL.

"The market is differentiating across credits once again," he said. "What we're seeing today is a return to healthy market discourse and healthy market behavior in terms of appropriately evaluating risk and spreads."

Bloomberg Markets

By Amanda Albright

April 26, 2022